

SMALL BUSINESS ADMINISTRATION

13 CFR Part 107

Small Business Investment Companies – Administrative Fees

RIN: 3245-AG65

AGENCY: U.S. Small Business Administration.

ACTION: Proposed rule.

SUMMARY: The U.S. Small Business Administration (SBA) proposes to increase the Small Business Investment Company (SBIC) licensing and examination fees. The Small Business Investment Act of 1958, as amended, allows SBA to collect licensing and examination fees to offset SBA's costs associated with the administration of these two activities. SBA last increased fees for SBICs in 1996. Current fees offset less than 40% of SBA's administrative expenses related to these activities. The proposed rule would revise existing regulations to increase, over a five-year period, SBIC licensing and examination fees in order to annually recoup an estimated 70% of SBA administrative expenses related to these activities. After the five year period, the rule proposes annual increases of these fees based on inflation. To encourage investment into underserved areas, the proposed rule would establish certain examination fee discounts for SBICs that make significant low and moderate income (LMI) investments.

DATES: Comments on the proposed rule must be received on or before [INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER].

ADDRESSES: You may submit comments, identified by RIN 3245-AG65, by any of the following methods:

- Federal eRulemaking Portal: <http://www.regulations.gov>. Follow the instructions for submitting comments.
- Mail, Hand Delivery/Courier: Mark Walsh, Associate Administrator for the Office of Investment and Innovation, U.S. Small Business Administration, 409 Third Street, SW., Washington, DC 20416.

SBA will post comments on <http://www.regulations.gov>. If you wish to submit confidential business information (CBI) as defined in the User Notice at <http://www.regulations.gov>, please submit the information to Theresa Jamerson, Office of Investment and Innovation, 409 Third Street, SW, Washington, DC 20416. Highlight the information that you consider to be CBI and explain why you believe this information should be held confidential. SBA will review the information and make the final determination of whether it will publish the information or not.

FOR FURTHER INFORMATION CONTACT: Theresa Jamerson, Office of Investment and Innovation, (202) 205-7563 or sbic@sba.gov.

SUPPLEMENTARY INFORMATION:

I. Background Information

The Small Business Investment Act of 1958, as amended, authorizes SBA to collect fees to cover the costs associated with the licensing and examination of SBICs. 15 U.S.C. 681(e)(2)(B) and 687b(b). Although SBA has regulations setting the amount of these fees, SBA has not increased licensing and examination fees for SBICs since 1996. As part of the final rule published January 31, 1996 (61 FR 3177), SBA set licensing fees “to reflect the Agency’s costs of processing applications” and similarly set examination fees to “produce total revenue sufficient to cover the current direct costs to

SBA of conducting examinations.” In a subsequent rule published on April 30, 1997 (62 FR 23337), SBA capped examination fees at \$14,000, which lowered the fee for SBICs with over \$60 million in assets. As part of the rationale for this change, the rule stated, “many of the largest SBICs are bank-owned and do not use federal leverage, so that fees computed on the basis of total assets do not appropriately reflect the level of effort and risk associated with the examination process.” In December 1996, only 6 of the 28 SBICs with over \$60 million in assets used leverage and only 1 of the 12 SBICs with over \$120 million in assets used leverage. As of September 14, 2016, 114 of the 121 SBICs with over \$60 million in assets used leverage and 64 of the 66 SBICs with over \$120 million in assets used leverage. Since nearly all of the SBIC program’s largest SBICs now utilize leverage, the rationale stated in the 1997 rule as a basis for reducing examination fees no longer applies.

The 1997 rule, which remains in place today, does not include an inflation adjustment for these fees. Consequently, these fees have not kept pace with rising SBA costs due to changes in inflation and increased risk in its portfolio. In 1996 when the fees were most recently increased to cover SBA’s costs, aggregate outstanding SBA leverage was less than \$1.4 billion; this figure has grown to \$10.4 billion as of June 30, 2016. Licensing and examination fees received in Fiscal Year (FY) 2015 were slightly lower than those received in FY 1999 (the earliest date fees paid and SBA expenses for these activities are readily available) because, at that time, SBA was licensing SBICs issuing Participating Securities (in addition to SBICs issuing only Debentures), which pay higher licensing and examination fees than SBICs issuing only Debentures. While licensing and examination fees have decreased, SBA’s expenses related to licensing and examination

activities have doubled due to inflation and the cost of obtaining necessary resources to manage SBA's increased risk.

Although fees set in 1996, as adjusted in 1997, were intended to fully reimburse SBA's costs, by FY 1999, licensing and examination fees only covered approximately 85% of SBA's related expenses. In FY 2015, licensing and examination fees covered less than 40% of SBA's related licensing and examination expenses.

In FY 2015, SBA processed 44 Management Assessment Questionnaires as part of its initial licensing review and 32 SBIC license applications in its final licensing review. SBA collected approximately \$0.4 million in SBIC licensing fees, which reimbursed less than a quarter of SBA's expenses associated with licensing. In FY 2015 SBA issued 222 exam reports for over 300 operating SBICs and collected \$1.8 million in examination fees, reimbursing less than half of SBA's costs associated with examination activities. SBA's Office of Inspector General (OIG) also noted the disparity between examination costs and fees collected in Audit Report 13-22: Improved Examination Quality Can Strengthen SBA's Oversight of Small Business Investment Companies (available at <http://www.sba.gov/oig/audit-report-13-22-improved-examination-quality-can-strengthen-sbas-oversight-small-business>), stating, "while the SBA has continued to exercise its statutory authority to collect examination fees, we determined the fees were not sufficient to keep pace with rising costs." OIG Audit Report 13-22 at 8.

The primary reason that licensing and examination fees do not cover the current cost of these activities is inflation. Another factor is the increased number of SBICs utilizing higher amounts of leverage. Since 1996 (when the fees were last increased), the number of leveraged SBICs with assets over \$60 million has risen from 6 SBICs in 1996

to 114 in September 2016. SBA applies a higher level of credit analysis to leveraged SBICs than non-leveraged SBICs in both licensing and exams. Another factor is that SBA has intensified its licensing activities in the past ten years due to the increased amounts of leverage sought by applicants and in order to improve the quality of its SBIC portfolio. SBA has adopted many industry best practices in its licensing process, including accessing relevant private equity performance resources and benchmarking applicants to industry performance. These industry-standard best practices cost money. For example, SBA spent over \$100,000 for information subscription services to support licensing activities in FY 2016. However, SBICs ultimately benefit financially from improvements in the quality of the SBIC program portfolio through lower annual charges on SBA-guaranteed debenture leverage. SBA formulates the annual charge each year to keep the program at zero subsidy cost. The SBIC debenture leverage annual charge has decreased from 1% in FY 1999 to an annual charge of 0.347% in FY 2017, reflecting improvements to the SBIC debenture portfolio.

Even with these improvements, SBA recognizes that its oversight capabilities must continue to improve, particularly in the areas of technology and training in connection with its licensing and examination activities. As indicated by the OIG's report, "without proper training and technology examiners may not effectively identify all regulatory violations as intended by the Act." OIG Audit Report 13-22 at 11. Testimony to the House Small Business Committee on behalf of the Small Business Investor Alliance in July 2013 also indicated that the SBIC Program has "a number of major technological and information systems challenges." *Examining the Small Business Investment Company Program: Hearing before the House Subcommittee on*

Investigations, Oversight and Regulations, 113th Congress (Statement by Steven Brown, President, Trinity Capital Investment, testifying on behalf of the Small Business Investor Alliance), which may be found at http://smallbusiness.house.gov/uploadedfiles/7-25-2013_steven_brown_testimony_final_july_25.pdf. In order to overcome some of these technological challenges, SBA needs to expand its web-based reporting application to address licensing and examinations needs. These efforts are expected to increase licensing and examination costs by \$500,000 annually. SBA believes that improvements in its web-based tools will facilitate the exchange and analysis of information and result in more effective licensing and examination activities, as well as improve efficiency and ease of use by SBIC program stakeholders. To address identified training needs, SBA expects to incur additional training costs amounting to between \$50,000 and \$100,000 to support analysts in licensing and examinations.

Finally, due to recent attrition in staffing and to address peaks in licensing, SBA expects to hire contractors to support both examinations and licensing processes. Due to the specialized skill set associated with these activities, SBA estimates additional contracting resources may cost an additional \$600,000 for examinations and up to \$400,000 for licensing annually.

Based on estimated costs for FY 2017, SBA projects costs exceeding \$2 million for SBIC licensing activities and \$4.5 million for SBIC examination activities. SBA is not currently proposing to increase fees to 100% of its anticipated costs; SBA estimates the proposed fees would recoup only 70% of its anticipated licensing and examination costs. Under this proposed rule, SBA seeks to increase SBIC licensing and examination fees in order to: (1) recoup a significant portion of its projected expenses associated with

licensing and examination activities; (2) pay for necessary technology upgrades related to licensing and examinations; (3) pay for additional licensing and examiner training; (4) pay for necessary information resources commonly available to private equity fund of funds to support due diligence, analysis and decision-making in the licensing area; and (5) pay for contractors with specialized expertise to help support staff associated with licensing and examination-related activities. SBA proposes to increase these fees over a five year period in order to provide a more gradual impact on SBICs and then annually adjust these fees for inflation beginning on October 1, 2021. SBA may consider increasing its fees to reimburse more of its expenses at a later time, but will be mindful of any impact on the level of interest in the program.

II. Section by Section Analysis

A. Indexing Fees

Section 107.50 Definition of terms.

In order to adjust licensing and examination fees to remain current with inflation after the five year period, SBA proposes to add the defined term “Inflation Adjustment”, which would be defined as the methodology used to increase SBIC administrative fees using the consumer price index for all urban consumers (CPI-U), as calculated by the U.S. Bureau of Labor and Statistics (BLS), based on the U.S. city average for all items, not seasonally adjusted, with the base period 1982-84=100. After consulting with BLS, SBA chose this index because it reflects the average change in the prices paid for a market basket of goods and services and is most frequently used in escalation agreements, as discussed on the BLS website (<http://www.bls.gov/cpi/cpi1998d.htm>). Historical CPI-U values may be found at <http://data.bls.gov/timeseries/CUUR0000SA0?>.

Beginning October 1, 2021, SBA would recalculate the examination and licensing fees annually to reflect increases in the CPI-U at the beginning of each government fiscal year (October 1) based on the change in the index from the previous year and round the amount to the nearest \$100. If the CPI-U decreases, no change will be made to the fees. SBA will publish the resulting fees in a notice in the Federal Register each year prior to the date of the increase. SBA is proposing to calculate the increase based on the change from the previous year's June CPI-U to the most recent June CPI-U, which will provide sufficient time for SBA to publish the revised fee before October. For example, the CPI-U is 238.638 in June 2015 and 241.038 in June 2016, a 1.0057% increase.

B. Licensing Fees

Section 107.300 –License application form and fee.

Regulations currently require SBIC applicants to pay a base fee of \$10,000 plus an additional \$5,000 if the applicant intends to operate as a limited partnership (Partnership Licensee). Most SBIC applicants are organized as limited partnerships and therefore currently pay a licensing fee of \$15,000. Applicants seeking to be licensed as Early Stage SBICs are required to pay both the additional \$5,000 Partnership Licensee fee and an additional \$10,000 Early Stage fee, for a total of \$25,000. Current regulations also include an additional \$5,000 fee for applicants intending to issue Participating Securities leverage (a type of leverage, no longer available, that was designed to encourage SBICs to invest in equity securities).

Current regulations require applicants to pay the licensing fee when they submit their complete license application, which initiates the final phase in the SBIC licensing process. SBA expends significant resources prior to this submission. The first phase in

the licensing process begins when a first time applicant submits its Management Assessment Questionnaire (“MAQ”), which consists of SBA Forms 2181 and exhibits A through F of SBA Form 2182, or when the management of an existing SBIC submits a request to SBA to be considered for a subsequent SBIC license. (SBIC application forms are available on SBA’s website at www.sba.gov/sbic.) SBA reviews the MAQ or subsequent SBIC applicant materials, performs due diligence, analyzes the management team’s performance, interviews those management teams invited for an in-person interview, and ultimately determines whether to issue a formal invitation (Green Light letter) to the applicant to proceed to the final licensing phase of the process. Once an applicant receives a Green Light letter, the applicant typically has up to 18 months to raise the requisite private capital. During this timeframe, SBA keeps in touch with the applicant, conducts SBIC training classes, and provides guidance as needed. The applicant pays the licensing fee only at the final licensing phase, which occurs when it submits its complete license application (consisting of an updated SBA Form 2181 and complete SBA Forms 2182 and 2183) after raising sufficient private capital. A number of applicants fail to raise the requisite capital or for other reasons do not submit a license application. As a result, SBA estimates that less than half of SBIC applicants pay the licensing fee, even though SBA expends resources on all applicants.

To clarify its existing practices, the proposed rule defines SBA’s licensing phases and what forms and fees are required at each phase as discussed above. SBA considered adding a fee at the beginning of the licensing process to help spread the costs across all applicants on which SBA expends resources, but decided not to pursue this approach so as to not discourage applicants from applying to the program. SBA invites comments on

whether SBA should charge a fee at the first phase to help spread the costs across all applicants on which SBA expends resources.

The proposed rule would remove the additional fee currently charged to applicants seeking to operate as a Partnership Licensee, since substantially all applicants intend to operate as a Partnership Licensee and this is not a significant variable in determining costs. The proposed rule also removes the additional fee for Participating Securities Licensees, since SBA stopped issuing commitments for Participating Securities Leverage and licensing new Participating Securities SBICs as of October 1, 2004. The proposed rule increases the licensing fee to \$25,000 in FY 2017, after the effective date of a final rule, with further increases of \$5,000 each October for the next 4 years, resulting in a licensing fee of \$45,000 by October 1, 2020. Beginning on October 1, 2021, SBA will increase the licensing fee using the Inflation Adjustment and, prior to the date of the increase, will publish the amount in a Notice in the Federal Register. As previously discussed, this increase will be used to offset SBA's costs associated with additional training, upgraded information technology, necessary subscription services, and specialized contractor support. Even with this increase, SBA expects these fees to offset less than half of SBA's licensing expenses by FY 2021. SBA may consider further increases in the future in order to fully cover the costs of its licensing activities as authorized by the Small Business Investment Act, but does not want to increase fees too sharply without better understanding the impact fee increases may have on application submission rates.

Section 107.410 – Changes in Control of Licensee.

SBA treats a change in control of a Licensee as a licensing action, since SBA must perform similar functions and processes to those in SBA’s final licensing phase. Current regulations require SBICs seeking a change in control to pay a \$10,000 fee, similar to the current licensing fee. Since the procedures and costs are similar to those in the final licensing process, the proposed regulations change the current fee to be equal to the licensing fee identified in proposed §107.300.

C. Examination Fees

Section 107.692 – Examination fees.

Current §107.692(b) provides for a base examination fee calculated as a percentage of an SBIC’s total assets at cost. As more specifically set forth in current §107.692(b), the percentage decreases as the assets increase, with the maximum base examination fee set at \$14,000 for SBICs with total assets greater than \$60 million.

Current §107.692(c) then provides for various adjustments to the base examination fee which are summarized in the table set forth in §107.692(d), as shown on Table 1: Current SBIC Examination Fee Adjustments, as follows:

TABLE 1: CURRENT SBIC EXAMINATION FEE ADJUSTMENTS

Examination fee discounts	Amount of discount— % of base examination fee	Examination fee additions	Amount of addition— % of base examination fee
No prior violations	15%	Partnership or limited liability company	5%
Responsiveness	10%	Participating Security Licensee	10%
		Records/Files at multiple locations	10%
		Early Stage SBIC	10%

Current §107.692(e) provides that SBA may assess an additional fee of \$500 per day if SBA determines the examination is delayed due to the SBIC's lack of cooperation or the condition of its records.

Proposed §107.692(b) would replace the base fee calculation with the following formula: Base Fee = Minimum Base Fee + 0.024% of assets at cost, but not to exceed the Maximum Base Fee. Both the Minimum Base Fee and the Maximum Base Fee would change each year as shown on Table 3: Minimum and Maximum Base Fees:

TABLE 3: MINIMUM AND MAXIMUM BASE FEES

Time Period (Based on the examination start date)	Minimum Base Fee	Maximum Base Fee for Non- leveraged SBICs	Maximum Base Fee for Leveraged SBICs
[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER] to September 30, 2017	\$5,000	\$20,000	\$20,000
October 1, 2017 to September 30, 2018	\$6,000	\$22,500	\$26,000
October 1, 2018 to September 30, 2019	\$7,000	\$25,000	\$32,000
October 1, 2019 to September 30, 2020	\$8,000	\$27,500	\$38,000
October 1, 2020 to September 30, 2021	\$9,000	\$30,000	\$44,000

For the purposes of calculating the examination fee, the proposed rule defines Non-leveraged SBICs as SBICs that have no outstanding SBA-guaranteed leverage or leverage commitments and, in the case of SBICs that have issued leverage in the form of Participating Securities, those SBICs that have no outstanding Earmarked Assets. An SBIC that satisfies these requirements must also certify to SBA that it will not seek new SBA leverage in the future. As discussed in the 1997 rule, non-leveraged SBICs pose no credit risk to SBA and therefore require less time to examine. The lower Maximum Base Fee for non-leveraged SBICs reflects this reduced effort. The lower Maximum Base Fee for non-leveraged SBICs also provides a small incentive for leveraged SBICs to repay

their leverage. By October 1, 2020, the examination fees are estimated to cover most of SBA's costs related to examination activities.

An example may be helpful to demonstrate the gradual phase-in of the proposed exam fees. Assume that in March 2019, a leveraged SBIC has \$125 million in assets at cost. The Base Fee would be equal to \$32,000, the Maximum Base Fee for that time period, since the Base Fee calculation ($\$7,000 + .024\% \times \125 million) computes to \$37,000. If the SBIC still had \$125 million in assets at cost and outstanding leverage in March 2021, the Base Fee would be \$39,000, since the Base Fee calculation ($\$9,000 + .024\% \times \125 million) would compute to \$39,000 and the Maximum Base Fee for leveraged SBICs would be \$40,000. If the SBIC had repaid all SBA leverage, had no leverage commitments and certified that it did not intend to seek leverage in the future, it would qualify as a non-leveraged SBIC and the Base Fee would be reduced to \$30,000, based on the non-leveraged Maximum Base Fee in March 2021.

In considering examination fees, SBA reviewed the expenses reported in the Form 468 related to private sector financial auditors (which perform activities similar to an examination). In FY 2015, private sector auditor expenses for SBICs ranged from \$35,000 to over \$65,000 (depending on the size of the fund) with an average audit cost of approximately \$43,000. By FY 2021, the SBIC Base Fee would range from \$9,000 to \$44,000 with an expected average examination fee of \$19,300. SBA believes the proposed examination fees are reasonable.

To keep the fees aligned with SBA's costs, beginning on October 1, 2021, the Base Fee would be adjusted annually by increasing both the Minimum and Maximum Base Fees using the Inflation Adjustment. For example, if the Inflation Adjustment was

1.5% between June 2020 and June 2021, the Minimum Base Fee beginning in FY 2022 would be \$9,100 and the Maximum Base Fee would be \$30,600 for non-leveraged SBICs and \$44,900 for leveraged SBICs.

Consistent with current regulations, proposed §107.692(b) only computes a Base Fee. That Base Fee is then increased or decreased using the adjustments defined in §107.692(c) to determine the final examination fee. Proposed §107.692(c) would change the examination fee adjustments to better reflect SBA costs and provide certain incentives to SBICs. These changes are identified below:

- Low and Moderate Income (LMI) Investing Discount: Proposed §107.692(c)(2) would apply a discount of 1% of the Base Fee for every \$10 million in LMI Investments (in dollars at cost) financed since the Licensee's last examination up to a maximum 10% of the Base Fee. SBA will not spend any less time or resources examining SBICs with LMI Investments as a result of this discount, but is including the discount in order to provide an incentive to SBICs to make LMI Investments.
- Remove Fully-responsive Discount and Non-responsiveness Addition: Current regulations provide a 15% discount if the SBIC is "fully responsive to the letter of notification of examination." Most SBICs currently receive this discount, and the proposed Base Fee already reflects the cost efficiencies resulting from responsiveness. To compensate SBA for the additional time associated with SBICs that are not responsive, proposed §107.692(c)(3) would add 15% of the Base Fee for non-responsiveness or "not fully responsive to the letter of notification of examination."

- Remove Additions for Partnership and LLC: Current regulations identify additions to the Base Fee for SBICs organized as partnerships or limited liability companies (LLCs). The proposed rule would remove these additional fees from §107.692(c). Since substantially all SBICs are organized as partnerships or LLCs, the cost to SBA of examining SBICs with this structure is reflected in the proposed Base Fee.
- Remove Additions for Participating Securities Licensees and Early Stage SBICs: Current regulations include additions to the Base Fee if the SBIC is authorized to issue Participating Securities or is licensed as an Early Stage SBIC. SBA promulgated these additional fees because these types of SBICs were perceived to engage in particularly complex financing transactions. However, given the sophistication of the financing transactions of many of today's SBICs, whether standard debenture SBICs or otherwise, SBA no longer sees a need for this fee adjustment and proposes to remove it from §107.692(c).
- Unresolved Finding Addition: SBA expends significant time monitoring and resolving examination findings that have remained unresolved for many months, and in some cases, years. SBA believes that SBICs should resolve all examination findings within 90 days from notification. To encourage SBICs to resolve findings in a timely manner, proposed §107.692(c)(5) would assess an additional fee equal to 5% of the Base Fee for every 30 calendar days or portion thereof for each examination finding that remains unresolved after a 90 calendar day grace period after the SBIC is notified that corrective action must be taken to

resolve an examination finding, unless SBA ultimately resolves the finding in the SBIC’s favor.

As an example, if an SBIC is notified on May 1, 2018 of an examination finding that requires resolution, the SBIC would have 90 calendar days (through July 30, 2018) to resolve the finding. If the SBIC does not resolve the examination finding until September 10, 2018, the SBIC would have taken 132 days to resolve the finding, or 42 days beyond the 90 calendar day cure period. If the SBIC’s base examination fee was \$20,000, SBA would assess an additional fee of \$2,000 calculated as follows:

First 30 days:	\$1,000 (5% of Base Fee)
+ Next 12 days:	<u>\$1,000</u>
Total Unresolved Finding Addition: \$2,000	

If the SBIC had two findings that each took 132 days to resolve, the total unresolved finding addition would be \$4,000. There would be no additional charge if SBA ultimately resolved the finding in the SBIC’s favor.

Proposed §107.692(c)(1) keeps the 15% discount for SBICs that have no outstanding regulatory violations at the time of the commencement of the examination and no violations as a result of the most recent prior examination. Proposed §107.692(c)(5) retains the 10% addition charged to SBICs that maintain records located in multiple locations. SBA believes both these adjustments continue to be appropriate.

A summary of the resulting proposed examination fee discounts and additions is summarized in Table 4: Proposed Examination Fee Discounts and Additions, below:

TABLE 4: PROPOSED EXAMINATION FEE DISCOUNTS AND ADDITIONS

Examination Fee discounts	Amount of discount - % of Base Fee	Examination Fee additions	Amount of addition - % of Base Fee
No outstanding violations; no violations in prior exam	15%	Non-responsive	15%
LMI Investments	1% of Base Fee for every \$10 million in LMI Investments funded since the last examination up to a maximum discount of 10% of Base Fee	Records/Files at multiple locations	10%
		Unresolved Findings	5% of Base Fee for every 30 days or portion thereof beyond the 90 day grace period for each unresolved finding

Just as with current §107.692, the final examination fee is calculated by taking the Base Fee determined under §107.692(b) and adding or deducting the adjustments identified in proposed §107.692(c). The following example demonstrates this calculation. Assume that in March 2019, a leveraged SBIC has \$125 million in assets at cost. The Base Fee calculation ($\$8,500 + .024\% \times \200 million) computes to \$38,500. Since the Base Fee may not exceed the Maximum Base Fee for the relevant time period, the Base Fee would be equal to \$30,000. If the SBIC is non-responsive to the examiner's requests, has records in multiple locations, and does not qualify for any of the proposed discounts, the examination fee would be calculated as follows:

\$30,000	Base Fee determined per proposed §107.692(b)
+ \$ 4,500	15% addition for non-responsiveness per proposed §107.692(c)(3)
<u>+ \$ 3,000</u>	10% addition for records in multiple locations per proposed §107.692(c)(4)
\$37,500	Examination Fee

Although the Base Fee has a minimum and maximum, the resulting examination fee does not have a minimum or maximum. Unresolved findings beyond the 90-day

grace period could result in increasingly higher examination fees. These additions are intended to incentivize SBICs to be responsive and resolve any findings as quickly as possible.

Proposed § 107.692(e) changes the current \$500 per day delay fee to \$700 per day, which will be adjusted annually using the Inflation Adjustment, beginning on October 1, 2021 to coincide with the date on which the other fee inflation adjustments are computed.

Compliance with Executive Orders 12866, 12988 and 13132, the Paperwork Reduction Act (44 U.S.C. Ch. 35) and the Regulatory Flexibility Act (5 U.S.C. 601-612)

Executive Order 12866

The Office of Management and Budget has determined that this rule is not a “significant” regulatory action under Executive Order 12866. However, to provide additional transparency for the SBIC community, a Regulatory Impact Analysis is set forth below.

1. Necessity of Regulation

The Small Business Investment Act authorizes SBA to collect administrative fees to cover licensing and examination costs. Currently, licensing fees cover less than a quarter of SBA’s licensing costs and examination fees cover less than half of examination costs. It is critical that SBA increase fees in order to (1) improve its technology for both licensing and examinations; (2) improve examiner training; (3) pay for necessary information subscription services; and (4) provide contractor resources to support licensing and examination activities.

2. Alternative Approaches to the Regulation

A. Licensing Fees

SBA considered several alternatives to the proposed regulations regarding licensing fees. SBA first considered indexing the licensing fees for inflation from 1996 (the year in which SBA most recently raised licensing fees) to 2017. This alternative did not produce sufficient fees to offset SBA licensing costs and produced lower licensing fees than those in the proposed rule. SBA therefore rejected the option of adjusting the current fees only for inflation.

Given its technology and processing time concerns, SBA considered higher licensing fees than those in the proposed rule in order to obtain the same technology and resources utilized by industry peers and further use of contractor support to reduce times in the licensing process. Although increasing fees even higher than SBA is proposing would provide more resources, SBA believes the proposed fee increases would be sufficient to meet essential needs while remaining well within the ability of qualified applicants to pay.

SBA considered adding a fee at the first licensing phase (Initial Review), but was concerned that this might substantially reduce the number of applicants to the program. SBA invites comments from industry as to whether SBA should add a fee at the first licensing phase to help spread costs across all applicants on which SBA expends resources.

SBA also considered implementing a larger increase in FY 2017 in order to offset costs more quickly. SBA opted to pursue the gradual increase identified in the proposed rule to allow potential applicants time to adjust to these increases.

B. Examination Fees

SBA considered several alternatives to the proposed regulations regarding examination fees. SBA considered indexing the fees utilizing the existing table in current §107.692(b) to reflect inflation from 1997 to 2017. This alternative did not produce sufficient fees to offset SBA costs in examinations. In assessing the reasons for this, SBA analyzed the SBIC portfolios from both periods, and recognized that the SBIC portfolio in 1997 was significantly different than today. In 1997, most of the SBICs with the highest total assets were bank-owned SBICs that did not issue SBA leverage and therefore required less time and resources for SBA to examine. Today, most of the highest-asset SBICs have significant amounts of SBA leverage. Therefore, merely indexing the existing fees would not appropriately reflect the costs associated with examinations.

SBA also considered proposing examination fee increases that were only sufficient to cover current costs and did not cover additional money needed to address technology upgrades, training, or contractor support. SBA rejected this alternative for three reasons. First, the OIG indicated the need for improved technology and training for examiners and suggested that SBA increase its fees to cover these costs. SBA agrees that such resources would improve the examination function. Second, SBA believes its proposed examination fees are less than fees charged for similar activities such as financial audits. SBA calculated the median private sector financial audit fee paid by SBICs in FY 2015 to be \$43,000, where the proposed fees would result in an average Base Fee of \$19,300 in FY 2021. Third, while SBA's outstanding leverage in its operating portfolio has more than tripled from \$3.1 billion at the end of September 30, 2000 to \$10.4 billion as of June 30, 2016, the number of personnel in SBIC Examinations

has declined by over a third. In order to continue to monitor the SBIC program at the same level as in previous years, SBA will likely need to hire contractors with specialized skills to support this function.

SBA also considered a flat examination fee, regardless of the asset cost. SBA believes its examination activities are similar to financial auditor or bank examiner activities, which typically are based on asset cost and therefore rejected this alternative.

SBA considered increasing the fees to cover most of its cost in FY 2017, but believes that a gradual increase over a five year period would allow SBICs time to budget and adjust to the higher fees.

3. Potential Benefits and Costs

SBA anticipates this proposed rule may benefit the taxpayer by covering a larger portion of SBIC program administrative costs through the collection of an additional estimated \$3 million to \$4 million per year by October 2020. As noted above, these increased fees will (1) improve SBIC program technology for both licensing and examinations, (2) improve examiner training, (3) pay for necessary information subscription services, and (4) provide contractor resources to support licensing and examination activities. Collections are expected to increase annually each year beginning in October 2021 based on the CPI-U Inflation Adjustment.

The proposed rule would increase licensing costs for applicants and examination costs for SBICs. The proposed rule would, by October 2020, increase licensing costs by \$30,000 for all applicants that submit a complete license application. Based on the proposed rule, SBA estimates that by October 2020, the average non-leveraged examination fee would increase by \$5,100 and the average examination fee for leveraged

SBICs would increase by \$12,100 based on FY 2015 examinations data. These fees would further impact SBICs through annual increases to reflect inflation.

Executive Order 13563

A description of the need for this regulatory action and benefits and costs associated with this action is included above in the Regulatory Impact Analysis under Executive Order 12866.

In considering this proposed rule, SBA talked with fund of fund managers, auditors, and contractors to determine whether the proposed fees were reasonable. In reviewing organizational costs for SBIC applicants, including legal and other professional costs, SBIC applicants often incur organizational costs amounting to around \$500,000. The proposed increased licensing fee represents a small percentage of the total organizational costs typically incurred by SBIC applicants. SBA also compared Federal bank examiner fees and SBIC auditor fees (based on the SBIC annual Financial Reporting Form 468s submitted in 2015) with proposed SBIC examination fees. SBA believes the proposed licensing and examination fees are reasonable in comparison to the market.

Executive Order 12988

This action would meet applicable standards set forth in section 3(a) and 3(b)(2) of Executive Order 12988, Civil Justice Reform, to minimize litigation, eliminate ambiguity, and reduce burden. The action would not have retroactive or presumptive effect.

Executive Order 13132

For the purposed of Executive Order 13132, SBA has determined that the rule would not have substantial, direct effects on the States, on the relationship between the national government and the States, or on the distribution of power and responsibilities among the various levels of government. Therefore, for the purpose of Executive Order 13132, Federalism, SBA has determined that this proposed rule has no federalism implications warranting the preparation of a federalism assessment.

Paperwork Reduction Act, 44 U.S.C. Ch. 35

For purposes of the Paperwork Reduction Act, 44 U.S.C. Ch. 35, SBA has determined that this rule would not impose any new reporting or recordkeeping requirements.

Regulatory Flexibility Act, 5 U.S.C. 601-612

The Regulatory Flexibility Act (RFA), 5 U.S.C. 601, requires administrative agencies to consider the effect of their actions on small entities, small non-profit businesses, and small local governments. Pursuant to the RFA, when an agency issues a rule, the agency must prepare an Initial Regulatory Flexibility Act (IRFA) analysis which describes whether the impact of the rule will have a significant economic impact on a substantial number of small entities. However, §605 of the RFA allows an agency to certify a rule, in lieu of preparing an IRFA, if the rulemaking is not expected to have a significant economic impact on a substantial number of small entities. This proposed rule would affect all applicants that submit applications at final licensing (which averaged 35 per year for FYs 2013 to 2015), and all operating SBICs (currently approximately 300). SBA estimates that approximately 98% of these SBICs are small entities. Therefore, SBA has determined that this proposed rule does have an impact on a substantial number

of small entities. However, SBA has determined that the impact on entities affected by the rule is not significant.

As noted above, proposed §107.300 would increase licensing costs by \$30,000 by October 1, 2020 for all applicants that submit a license application, which represents less than 0.1% of the average applicant's Regulatory Capital based on newly licensed SBICs between October 1, 2014 and June 30, 2016. Many applicants have organizational costs totaling around \$500,000, and some have far in excess of that amount. The proposed FY 2021 licensing fee of \$45,000 would represent a small fraction of those costs.

SBA estimates that proposed §107.692 would eventually increase the average examination fee by \$5,100, representing approximately 0.02% of the average non-leveraged SBIC's Regulatory Capital, and the average leveraged SBIC examination fee by \$12,100, representing approximately 0.01% of the average total capital under management (Regulatory Capital and outstanding SBA guaranteed leverage). As a point of comparison, most SBIC managers charge management fees of approximately 2% of capital under management. (Management fees, like the examination fees, are paid by the SBIC.) For a leveraged SBIC with \$50 million in Regulatory Capital and using 2 tiers of leverage charging a 2% management fee, the management fee would equal \$3 million a year. If the leveraged SBIC had assets at cost of \$150 million, no regulatory violations, and did not incur any exam fee additions, the exam fee in FY 2021 would amount to \$37,400 (\$44,000 minus the 15% discount for no violations), representing 0.025% of the SBIC's total capital. The examination fee would be a very small percentage of the SBIC's expenses.

SBA believes that most applicants with sufficient private equity experience and capital raising ability will not be discouraged from applying to the program based on the proposed administrative fee increases. SBA asserts that the economic impact of the rule is minimal. Accordingly, the Administrator of the SBA certifies that this proposed rule would not have a significant impact on a substantial number of small entities.

List of Subjects in 13 CFR Part 107

Examination fees, Investment companies, Loan programs-business, Licensing fees, Small businesses.

For the reasons stated in the preamble, SBA proposes to amend 13 CFR part 107 as follows:

PART 107 - SMALL BUSINESS INVESTMENT COMPANIES

1. The authority citation for part 107 continues to read as follows:

Authority: 15 U.S.C. 681, 683, 687(c), 687b, 687d, 687g, 687m.

2. Amend §107.50 by adding a definition of “Inflation Adjustment” to read as follows:

§ 107.50 Definitions of terms.

* * * * *

Inflation Adjustment is the methodology used to increase SBIC administrative fees using the Consumer Price Index for Urban Consumers (CPI-U), calculated by the U.S. Bureau of Labor and Statistics (BLS), using the U.S. city average for all items, not seasonally adjusted, with the base period of 1982-84=100. To calculate the Inflation Adjustment, each year, SBA will divide the CPI-U from the most recent June by the CPI-

U from June of the preceding year. If the result is greater than 1, SBA will increase the relevant fees as follows:

(1) Multiply the result by the current fee; and

(2) Round to the nearest \$100.

* * * * *

3. Revise §107.300 to read as follows:

§ 107.300 License application form and fee.

SBA evaluates license applicants in two review phases: (1) initial review and (2) final licensing, as follows:

(a) *Initial review.* Except as provided in this paragraph, SBIC applicants must submit a MAQ. MAQ means the Management Assessment Questionnaire in the form approved by SBA and available on SBA's website at www.sba.gov/sbic. An applicant under Common Control with one or more Licensees must submit a written request to SBA to be considered for a license and is exempt from the requirement in this paragraph to submit a MAQ unless otherwise determined by SBA in SBA's discretion.

(b) *Final licensing.* (1) An applicant may proceed to the final licensing phase only if notified in writing by SBA that it may do so. Following receipt of such notice, in order to proceed to the final licensing phase, the applicant must submit (i) a complete license application, in the form approved by SBA and available on SBA's website at www.sba.gov/sbic, within the timeframe identified by SBA and (ii) the Licensing Fee. The Licensing Fee means a non-refundable fee (determined as of the date SBA accepts the application) fee adjusted annually as follows:

Time Period	Licensing Fee
[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER] to September 30, 2017	\$25,000
October 1, 2017 to September 30, 2018	\$30,000
October 1, 2018 to September 30, 2019	\$35,000
October 1, 2019 to September 30, 2020	\$40,000
October 1, 2020 to September 30, 2021	\$45,000

(2) Beginning on October 1, 2021, SBA will annually adjust the fee using the Inflation Adjustment and will publish a Notice prior to such adjustment in the Federal Register identifying the amount of the fee.

5. In §107.410, revise paragraph (b) to read as follows:

§ 107.410 Changes in Control of Licensee (through change in ownership or otherwise).

* * * * *

(b) *Fee.* A processing fee equal to the Licensing Fee defined in §107.300(b) must accompany any application for approval of one or more transactions or events that will result in a transfer of Control.

5. In §107.692, revise paragraphs (b) through (e) to read as follows:

§ 107.692 Examination Fees.

* * * * *

(b) *Base fee.* (1) The Base Fee will be assessed based on your total assets (at cost) as of the date of your latest certified financial statement, including if requested by SBA in connection with the examination, a more recently submitted interim statement. For purposes of this § 107.692, Base Fee means the Minimum Base Fee plus 0.024% of

assets at cost, rounded to the nearest \$100, not to exceed the Maximum Base Fee. The Minimum and Maximum Base Fees are adjusted annually as follows:

Time Period (Based on the examination start date)	Minimum Base Fee	Maximum Base Fee for Non- leveraged SBICs	Maximum Base Fee for Leveraged SBICs
[INSERT DATE 60 DAYS AFTER DATE OF PUBLICATION IN THE FEDERAL REGISTER] to September 30, 2017	\$5,000	\$20,000	\$20,000
October 1, 2017 to September 30, 2018	\$6,000	\$22,500	\$26,000
October 1, 2018 to September 30, 2019	\$7,000	\$25,000	\$32,000
October 1, 2019 to September 30, 2020	\$8,000	\$27,500	\$38,000
October 1, 2020 to September 30, 2021	\$9,000	\$30,000	\$44,000

(2) In the table in paragraph (b)(1) of this section, a Non-leveraged SBIC means any SBIC that, as of the date of the examination, has no outstanding Leverage or Leverage commitment, has no Earmarked Assets, and certifies to SBA that it will not seek Leverage in the future. Beginning on October 1, 2021, SBA will annually adjust the Minimum Base Fee and Maximum Base Fees using the Inflation Adjustment and will publish a Notice prior to such adjustment in the Federal Register identifying the amount of the fees.

(c) *Adjustments to base fee.* In order to determine the amount of your examination fee, your Base Fee, as determined in paragraph (b) of this section, will be adjusted (increased or decreased) based on the following criteria:

(1) If you have no outstanding regulatory violations at the time of the commencement of the examination and SBA did not identify any violations as a result of the most recent prior examination, you will receive a 15% discount on your Base Fee;

(2) If you have funded at least \$10 million in LMI Investments at cost since the last examination, you will receive a 1% discount for every \$10 million in LMI Investments made since the last examination up to a maximum of a 10% discount on your Base Fee;

(3) If you were not fully responsive to the letter of notification of examination (that is, you did not provide all requested documents and information within the time period stipulated in the notification letter in a complete and accurate manner, or you did not prepare or did not have available all information requested by the examiner for on-site review), you will pay an additional charge equal to 15% of your Base Fee;

(4) If you maintain your records/files in multiple locations (as permitted under §107.600(b)), you will pay an additional charge equal to 10% of your Base Fee; and

(5) For any regulatory violation that remains unresolved 90 days from the date SBA notified you that you must take corrective action (as established by the date of the notification letter), you will pay an additional charge equal to 5% of the Base Fee for every 30 days or portion thereof that the violation remains unresolved after the 90 day cure period, unless SBA resolves the finding in your favor.

(d) *Fee discounts and additions table.* The following table summarizes the discounts and additions noted in paragraph (c) of this section:

Examination Fee discounts	Amount of discount - % of Base Fee	Examination Fee additions	Amount of addition - % of Base Fee
No outstanding violations; no violations in prior exam	15%	Non-responsive	15%
LMI Investments	1% of Base Fee for every \$10 million in LMI Investments made since the last examination up to a maximum discount of 10% of Base Fee	Records/Files at multiple locations	10%
		Unresolved Findings	5% of Base Fee for every 30 days or portion thereof beyond the 90 day grace period for each unresolved finding

(e) *Delay fee.* If, in the judgment of SBA, the time required to complete your examination is delayed due to your lack of cooperation or the condition of your records, SBA may assess an additional fee of \$700 per day. Beginning on October 1, 2021, SBA will annually adjust this fee using the Inflation Adjustment and will publish a Notice prior to such adjustment in the Federal Register identifying the amount of the fee.

Dated: November 17, 2016

Maria Contreras-Sweet,
Administrator

[FR Doc. 2016-30104 Filed: 12/15/2016 8:45 am; Publication Date: 12/16/2016]